

What happens when an insurance company becomes financially unhealthy – Rehabilitation or Liquidation?

This fact sheet will help you understand what steps the OIC can take to assist financially troubled companies. It will explain how guaranty associations work and what consumer protections they provide. It also includes frequently asked questions and answers and resources for additional information.

Introduction

When consumers purchase an insurance policy, they expect the terms and conditions of the policy to be fulfilled. And in the event that it is needed, they also expect to receive the protection they purchased.

Washington consumers can be confident knowing that they have a strong consumer protection advocate in the Office of the Insurance Commissioner (OIC). The OIC oversees all lines of insurance in the state and enforces the laws and regulations that insurance companies must follow in order to do business in our state.

The OIC has the authority to step in and take necessary steps to make sure insurers follow the law and it can take away an insurer's license if they:

- Violate Washington insurance laws
- Operate in a financially hazardous manner
- Become insolvent and no longer have the money needed to meet their obligations or the reserves required by state law

The OIC's Company Supervision Division

The Company Supervision Division of the OIC monitors the financial stability of insurers. It makes sure they have the required licenses and when necessary, supervises the rehabilitation of financially troubled insurance companies.

Sometimes the OIC takes on the role of liquidator. As liquidator, the OIC manages the liquidation of insolvent insurance companies and other entities by physically taking over and eventually closing the company offices, converting all assets into cash, and preparing the accounting records for the estates.

Depending on the severity of the problem, the insurer may be subject to:

- *An order of suspension*
- *An order of rehabilitation*
- *An order of liquidation*

An order of suspension may require the insurance company to halt all or a portion of its business.

In more severe cases, the OIC will request an *order of rehabilitation* or an *order of liquidation* from the Superior Court of Washington.

An *order of rehabilitation* allows the insurance company to stay in business, but the Insurance Commissioner is appointed as the rehabilitator and is given the power to manage the company until the problems are corrected. If the problems cannot be corrected, the company may be placed into liquidation.

An *order of liquidation* forces the insurance company out of business. When this happens, the Insurance Commissioner is appointed as the liquidator under a court order, and is directed to collect the assets of the company, paying its bills to the extent possible.

The OIC may also seek an *order of liquidation* if an unlicensed company is attempting to conduct the business of insurance in Washington.

The Rehabilitation Process

The rehabilitation process is less structured than a liquidation. In these cases, the OIC's goal is to return a financially troubled company to strength and make it an active and profitable company, while at the same time protecting policyholders, creditors and the public. The OIC is given broad powers in both the court order and in statute along with a great deal of discretion to take actions to correct the conditions that caused the problems and to prepare a plan to save the company.

All powers of the company's directors, officers and managers are suspended and must be delegated by the OIC.

A company will be released from rehabilitation when the court is satisfied that it is ready to resume normal operations. If the court determines that further efforts to rehabilitate the company would be ineffective, the court may issue an *order of liquidation*.

The Liquidation Process

All aspects of the liquidation process are governed by the insurer's liquidation statute. When the OIC determines that a Washington chartered insurance company is insolvent or is operating in a financially hazardous manner, the Insurance Commissioner may seek a liquidation order from the court. Based upon the consent of the company's board of directors or upon evidence at a hearing, the court will issue an *order of liquidation*.

This order includes a provision appointing the Insurance Commissioner as liquidator of the company. Under the court's authority, the liquidator is charged with gathering the company's assets, converting them into cash and distributing the cash to claimants against the company's estate.

Shortly after the liquidation order is issued, staff from the OIC's Company Supervision Division take possession of the company's offices, equipment, records, and assets. At that time, a notice is sent to all potential claimants informing them of the company's liquidation and the process they must follow to file a claim against the estate.

The liquidation statute establishes a set of priorities – or classes – for the payment of claims against the estate. All claims in a class must be paid in full (or reserves set aside to cover the class in full) before any payment is made to the next class. Within a class, all claims are equal and are paid equal *pro rata* shares if sufficient funds are not available to pay the class in full. There are nine classes of claims:

- **Class 1** -- Costs and expenses of administering the rehabilitation and liquidation
- **Class 2** -- Loss Claims for losses under policies
- **Class 3** -- Claims of the federal government other than claims under Class 2
- **Class 4** -- Reasonable compensation to employees for services performed
- **Class 5** -- Claims of general creditors
- **Class 6** -- Claims of state and local governments
- **Class 7** -- Claims filed late
- **Class 8** -- Surplus or contribution notes
- **Class 9** -- Claims of shareholders or other owners

The state's General Fund is not available to fund the liquidation of insolvent companies.

After all assets are converted into cash and all claims are prioritized and valued, the OIC will file a petition with the court asking for authority to distribute the cash according to the priority schedule. The liquidation process can take many years to complete.

Guaranty Associations

To protect policyholders and other claimants from the uncertainty of whether and when their claims will be paid, most states have established guaranty associations. Washington law established two such associations. One is for property and casualty insurance including automobile, homeowners, professional liability, malpractice, etc. The other is for life, health, disability and annuity.

The Washington guaranty associations protect Washington residents and property owners. Residents of other states and Washington residents owning property out of state are protected by other states' associations. Claims for policy benefits and claims for the return of unearned premium are referred directly to the appropriate guaranty association for consideration and payment. In most cases, claim payments begin within 90 days after an *order of liquidation* is issued.

While the guaranty association payments are limited by statutes which vary by state, most claims for policy benefits will be paid in full. Claims for policy benefits not paid by the association become claims against the liquidation estate. These claims are paid *pro rata* with all other policy claims including those of the guaranty associations.

Examples of such unpaid claims include:

- Life insurance claims for cash value in excess of the guaranty association limits
- Guaranty association deductibles and co-payments
- Interest rate rollbacks

If an insurer is placed into liquidation for a reason other than insolvency, the guaranty association does not provide coverage.

The Washington liquidation statute terminates all property/casualty policy coverage 30 days after the date of liquidation. However, life insurance policies, disability and health policies and annuities are usually kept in force since age and insurability make replacement expensive or even impossible. For these policies, the guaranty associations of the various states involved work together to find a buyer for the business and thereby transfer the policy obligations to a solvent insurance company.

Most licensed insurance companies are required to belong to the state guaranty associations that cover the lines of business the companies write. The associations' operations are funded through assessments from solvent member insurance companies, based on the amount of premiums received.

Other details

Residents of other states should contact the guaranty associations of their state for more information. Guaranty associations only cover insurance written by licensed insurers. In Washington, members of managed care plans – both health maintenance organizations (HMOs) and health care service contractors (HCSCs) – do not have guaranty association protection. Likewise, association coverage is not provided for licensed excess lines carriers. Excess lines carriers normally provide commercial insurance. If a claimant purchased insurance from an unlicensed entity or has coverage through a managed care plan, the consumer must rely on the Liquidator for possible payment of claims. If you have questions about whether or not your company is licensed, contact the Company Supervision Division at www.insurance.wa.gov.

Frequently Asked Questions

What happens when a company becomes insolvent and is liquidated?

Liquidation is similar to bankruptcy. When a company is liquidated, the Insurance Commissioner, as statutory liquidator, gathers the company's assets and determines its liabilities. The liquidator develops a plan to distribute the assets according to established law and submits it to the Superior Court of Washington for approval. When the plan is approved, the money from the company is distributed.

This procedure also applies if a company was operating without a license. If a company was not licensed, the chances are greater that there will be less money

available to pay claims. Policyholders and creditors will only receive payment from the funds available from the unlicensed liquidated company's assets.

If my company is placed into liquidation, will my claims be paid?

Generally, guaranty associations provide claim payments when a Washington licensed insurance company is placed into liquidation. These associations serve as a safety net for consumers insured by licensed insurance companies. Usually, the associations pay claims for policy benefits subject to limits in the policy and also limits established by law.

If an insurer is placed into liquidation for a reason other than insolvency, the guaranty association does not provide coverage.

If the company is not licensed, guaranty coverage will not be available. Also, managed care plans such as HMOs and HCSCs, and insurance provided by excess lines carriers generally are not part of the guaranty program.

Will my claim be paid in full?

In Washington, property/casualty claim payments are subject to a \$100 deductible. This means the first \$100 of the benefit amount is withheld, and the association will then pay the remainder of a claim subject to the policy limit or the guaranty association limit of \$300,000 – whichever is less.

Life/disability and annuity claims are paid subject to the policy limit or the guaranty association limit of \$500,000 – whichever is less. No deductible applies for these claims.

How long will it take for claims to be paid by the guaranty association(s)?

If a company licensed in Washington is placed into liquidation, guaranty associations typically are activated to pay claims as soon as the Court orders the liquidation. Claim payments usually begin within 60 to 90 days after the Court's order of liquidation is issued.

How many guaranty associations are there and how can I contact them?

The **Washington Insurance Guaranty Association (WIGA)** is responsible for valid policy claims of Washington residents or owners of property in Washington against liquidated property and casualty insurance companies licensed in Washington. Automobile, homeowners, and liability insurance are a few examples of property and casualty insurance. WIGA can be contacted at:

Western Guaranty Fund Services

1720 S. Bellaire, Suite 408

Denver, CO 80222

1-800-303-7565

The **Washington Life and Disability Insurance Guaranty Association** (WLDIGA) is responsible for valid policy claims of Washington residents against liquidated life, annuity and disability insurance companies licensed in Washington. (An example of disability insurance is medical insurance.) WLDIGA can be contacted at:

Washington Life & Disability Guaranty Association

P.O. Box 50303
Bellevue, WA 98015
(425) 562-3128

How can I tell if my insurance company is licensed in Washington?

To determine if a company is licensed in Washington, call the OIC's Company Supervision Division, at (360) 725-7200, or check the OIC website at www.insurance.wa.gov for a list of all insurance companies licensed in Washington.

The fact that a company is licensed does not guarantee that it always will remain solvent. However, it does mean that most policy claims can be considered for coverage up to the limits of the particular guaranty association. This safeguard is not available for policyholders of unlicensed insurance companies or, generally, for managed care plans such as HMOs and HCSCs.

How can I tell if my insurance company is financially sound?

You can check several sources to determine if your insurance company is financially sound. First, ask your insurance agent or broker. Second, contact the insurance company. Third, check your local library for the A.M. Best, Moody's, or Standard and Poors reference books which rate the financial condition of licensed insurance carriers. You also may ask the insurance company to provide you with this information.

Do I have guaranty association protection if I bought insurance from an unlicensed insurance company or from a managed care plan?

Unfortunately, when an insurance company is not licensed or the liquidated company is a managed care plan such as an HMO or HCSC, claims usually are not covered by guaranty associations. This means that claims must be paid solely from the assets of the liquidated company. As a result, policyholders may receive only partial payment, or in some cases, no payment at all for their claims.